No. 3584

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

JOHN C. DAVIS, as Trustee of the Estate of CHARLES F. WILLEY, in Bankruptcy,
Plaintiff in Error,

vs.

E. T. WILLEY,
Defendant in Error.

Upon Writ of Error to the Southern Division of the United States District Court of the Northern District of California, Second Division.

BRIEF FOR DEFENDANT IN ERROR.

WILLIAM E. BILLINGS,
Attorney for Defendant in Error.

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THE ACTION IS BARRED BY THE STATUTE OF LIMITATIONS.

The only question considered by the court below and which need be considered on this appeal is whether or not the cause of action alleged in the complaint of plaintiff in error is barred by the statute of limitations pleaded in the answer of defendant in error as a special defense. The court below held that it was barred by the said statute and we submit that said court committed no error in so holding.

As a special defense to the cause of action alleged in the complaint the defendant in error set up the statute of limitations (Tr. p. 9). The said statute is subdivision 4 of section 338 of the Code of Civil Procedure of the State of California, which reads as follows:

> "WITHIN THREE YEARS. An action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake."

We submit first that the evidence in this case conclusively shows that the creditor, McGinn, in whose shoes the plaintiff in error stands, was in possession of part of the facts constituting the alleged fraud more than four years before commencing the action and was thereby given a clew that would have warranted him as a reasonable man in making a further investigation which would have disclosed all the facts.

THE FACTS DISCLOSED.

In the automobile suit in which McGinn was present and heard the testimony and in which his attorney, Webster, appeared and examined the witnesses in which this particular evidence was disclosed the following facts were brought out by W. E. Burden, the assistant cashier of the bank (Tr. pp. 34-35):

> "Q. Have you any record of the First National Bank of Sonora of an account which was in the First National Bank of Sonora in the year 1912?

A. Yes I have.

Q. I would like you, if you would, refer to your record and testify, if you can, when that account was created, and when and in what manner it was closed if at all.

A. The account of E. T. Willey, special, was created May 28, 1912, and closed by one check in June, 1912, and another in Sept., 1912.

Q. What was the amount of the special account at the time it was created?

A. 1787.37.

Q. What was the amount of the check, June 12, 1912?

A. The check was June, $794.00.

Q. Drawn on that special account in June?

A. Yes, sir.

Q. Now have you any record of how that special account was created?

A. Why by a transfer—it was created by a certificate of deposit in the name of C. A. Belli.

Q. Have you the record as to what that certificate of deposit was open for?

A. It was a transfer of funds from the account of C. F. Willey.

Q. When was that transfer made?

A. Why, in February, 1912."

The above testimony was given in March 10, 1914. This action was commenced on March 26, 1918. Consequently four years and sixteen days, to be exact, before this action was commenced the creditor, McGinn, and his attorney, Mr. Webster, knew all the facts with reference to the creation of the special account which is one of the fraudulent transfers which is the basis of this suit. They knew that this special account of $1787.37 had been created from the funds of C. F. Willey, the bankrupt. With reference to this particular account

they knew as much as they later learned in the bankruptcy proceedings. And they knew this at the very time that they were attempting to show that the automobile was fraudulently claimed by E. T. Willey because it had been purchased with funds that belonged to C. F. Willey. I submit, therefore, that not only did the creditor, McGinn, have a clew of the facts upon which the fraudulent transfer was made, but that he knew the facts themselves so far as to the transfer of the $1787.37 was concerned and that as a reasonable man it was his duty to have then made the investigation that would also have disclosed the transfer of the $1500.00 account, and not having done so, he is now barred in this action.

THE LAW UPON THE SUBJECT.

The Supreme Court of the United States, the Federal courts and the Supreme and Appellate courts of this state have repeatedly held that under facts similar to the above the defendant is barred.

One of the leading cases upon the subject is that of

Wood v. Carpenter, 101 U. S. 135.

In this case Wood sued Carpenter and obtained a judgment against him for some $8000.00. Afterward Carpenter transferred practically all of his real and personal property of the value of some $500,000.00 to his brother. Then Wood had Carpenter arrested under a process to satisfy his debt

and Carpenter in that proceeding testified that he was worth only $20.00. Afterward Carpenter had his brother-in-law go to Wood and induce him to sell him his judgment against Carpenter for 50 cents on the dollar, which he did. Subsequently all the property was transferred back into Carpenter's name. This was an action to set aside the whole transaction as fraudulent. Some six years had elapsed since the consummation of the fraudulent acts complained of, but the plaintiff alleged in his complaint that the said fraudulent acts were secret and concealed and did not come to the knowledge of the plaintiff but shortly before the action was commenced. The defendant set up in a demurrer to the complaint the statute of limitations in Indiana, which is or was at the time of that action practically the same as the California statute which we are invoking here. For the purpose of the demurrer all of the facts as alleged above and which were set forth in the complaint were taken as true.

Judge Sawyer, in speaking for the court in sustaining the demurrer, said in part:

> "Statutes of limitations are vital to the welfare of society and are favored in the law. They are found and approved in all systems of enlightened jurisprudence. They promote repose by giving security and stability to human affairs. An important public policy lies at their foundation. They stimulate to activity and punish negligence. While time is constantly destroying the evidence of rights, they supply its place by a presumption which renders proof

unnecessary. Mere delay, extending to the limit prescribed, is itself a conclusive bar. The bane and antidote go together.

The provisions in the statute of which the plaintiff seeks to avail himself was originally established in equity and has since been made applicable in actions at law. * * * Upon looking carefully into the reply, we find that it sets forth that the concealment touching the cause of action was affected by the defendants by means of the several frauds and falsehoods averred more at length in the complaint. The former is only a brief epitome of the latter. There is the same generality of statement and denunciation and the same absence of specific detail in both. No point in the complaint is omitted in the reply but no new light is thrown in which tends to show the relation of cause and effect, or in other words that the protracted concealment which is admitted necessarily followed from the facts and circumstances which are said to have produced it. It is to be observed also that there is no averment that, during the long period over which the transactions referred to extended, the plaintiff ever made or caused to be made the slightest inquiry in relation to either of them. Proper diligence would not have failed to point a clew in every case that would have led to evidence not to be resisted with the strongest motive to action. The plaintiff was supine. If underlying fraud existed he did nothing to unearth it. Whatever is notice enough to excite attention puts the party on his guard and call for inquiry, is notice to everything to which said inquiry might have led."

Morris v. Haggin, 28 Fed. 275.

This was an action in equity for a discovery and to have set aside certain conveyances and judgments

under which defendants got control and possession of certain lands and property near Sacramento, California. The complaint alleged that defendant took advantage of plaintiff while he was in an incompetent state and condition of mind due to a severe blow on the head and secured the conveyances and judgments through fraud from plaintiff while he was in such a state and that the fraud was only discovered a short while before the commencement of the action. Defendant demurred on the ground that the action was barred by the same section of the statute of limitations which is invoked here. After discussing the proposition that courts of equity are bound by the same statute of limitations that might be pleaded in legal actions, the court goes on to state:

> "Unless, therefore, the case can be brought within some exception of the statute, the suit is barred. The only exception, if any, that can reach the case or is claimed to reach it, is found in Section 338, Code of Civil Procedure, Sub. 4, which provides that the period shall be three years in case of an action for relief on the ground of fraud or mistake; the cause of action is in such case not to be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud. * * * To ascertain of what acts a discovery of the facts constituting the fraud affording the ground of relief consists, we must go to the principles etablished in equity law, whence the idea was derived. The settled principles on this point are that the party defrauded must be diligent in making inquiry; that the means to knowledge are equivalent to knowledge; that a clew to the facts, which, if followed up diligently would

lead to a discovery is in law equivalent to a discovery—equivalent to knowledge. In stating the policy of statutes of limitations, and in illustrating these principles of construction applicable thereto, Mr. Justice Sawyer, speaking for the court in Wood v. Carpenter, supra (quoting from Wood v. Carpenter). He might have at least demanded possession and asked by what right he was kept out of his own. He might have brought a suit in ejectment and compelled defendants to show their title and how derived from him if any such title they had or he might have filed his bill of discovery, as he has now done at last in this suit, to ascertain by what right the defendants claimed to withhold his property from him. In the language of Mr. Justice Sawyer in Wood v. Carpenter, 'It does not appear from the averments of the bill that complainant ever made or caused to be made the slightest inquiry as to how he had been divested or despoiled of his large estate'."

The rules as above announced by the Supreme and Federal Courts of the United States are supported by the following cases:

Archer v. Freeman, 124 Cal. 528; 57 Pac. 474;
Bills v. Silver Mining Co. 106 Cal. 9; 39 Pac. 43;
Lady Washington Con. Co. v. Wood et al., 113 Cal. 482; 45 Pac. 809;
Truett v. Onderdonk, 120 Cal. 581; 53 Pac. 26;
Marks v. Evans, (Cal. 1900) 62 Pac. 76;
Hecth v. Slaney, 72 Cal. 363; 14 Pac. 88;
Burke v. Maguire, 154 Cal. 467; 98 Pac. 21;
Montgomery v. Peterson, 27 Cal. App. 671; 151 Pac. 23;

Davis v. Hibernia Sav. & Loan Soc., 21 Cal. App. 444; 132 Pac. 462;
Teall v. Slavin, 40 Fed. 774;
Teall v. Schrader, 158 U. S. 172.

The case of *Archer v. Freeman* (supra) well states the rule as it has been applied by the Supreme Court of this state. This was an action brought to recover damages claimed to have been sustained by plaintiff through certain misrepresentations with respect to the sale of land. The plaintiff commenced negotiations for the purchase of the land in question in November, 1887, and the transaction was completed in January, 1888, at which time he received the purchase money and received the deed for the land. The action was commenced June 25, 1894, which was between 6½ and 7 years after the alleged fraudulent misrepresentations and promises which are claimed to have been made and given at the time of the purchase. Therefore the statute of limitations had run more than twice from the times of the alleged frauds until the filing of the complaint unless under section 338 of the Code of Civil Procedure there was no discovery by the plaintiff of the facts constituting the alleged frauds until within three years next preceding the commencement of the action. The court then lays down the rule as follows:

> "However it is the clearly established law that in such a case a party must be held to have had knowledge of the alleged fraud whenever the means of knowledge existed and the circumstances were such as to put him on inquiry.

More v. Boyd, 74 Cal. 171, 15 Pac. 670, and cases there cited; Lataillade v. Orena, 91 Cal. 578, 27 Pac. 924; Bills v. Mining Co., 106 Cal. 9, 39 Pac. 43. Therefore, if the plaintiff had the means of knowledge, and was put upon inquiry as to the alleged frauds more than three years before the commencement of the suit, the action is barred."

In this case the fraud relied on consisted of certain alleged misrepresentations of defendants with respect to certain improvements that were going to be made and certain things that were going to be done in connection with the townsite in which plaintiff's property was sold and which plaintiff claimed that he purchased on the strength of these representations. The court held that if the plaintiff had made the proper inquiries and used the proper diligence he would have discovered these frauds within the statutory time.

The rule above stated has been restated time and time again by the Supreme Court of this state, as indicated by the cases above mentioned.

Truett v. Onderdonk (supra),

in which the court said, speaking through Judge Van Fleet:

"This lack of diligence is as fatal to the relief here sought as it would be in a direct action to recover for the fraud. Equity abhors a stale claim and it was incumbent upon plaintiff to show facts excusing his long delay in asserting the fraud. It is not enough to assert merely that the discovery could not have been made sooner. It must appear that it could not have been made by the exercise of reasonable dili-

gence. And all that reasonable diligence the discovery by the aggrieved party of the facts constituting fraud or mistake. Under the cases in this state it is not enough to assert that the discovery was not sooner made. It must appear that it could not have been made by the exercise of reasonable diligence; and all that reasonable diligence would have disclosed plaintiff is presumed to have known, means of knowledge in such a case being the equivalent of the knowledge which it would have produced. Truett v. Onderdonk, 120 Cal. 581, 588, 53 Pac. 26; Lady Washington Co. v. Wood, 113 Cal. 482, 486, 45 Pac. 809; Del Campo v. Camarillo, 154 Cal. 647, 98 Pac. 1049. See also Wood v. Carpenter, 101 U. S. 135, 140, 25 L. Ed. 807."

Applying the rule of law above laid down, we submit that this cause of action against defendant in error, Willey, is clearly barred by subdivision 4 of section 338 of the Code of Civil Procedure. The creditor McGinn knew at the time of the automobile suit and his attorney at that time knew by the unimpeachable record of the bank that the monies constituting the special account standing in the name of E. T. Willey had been transferred from the monies of Chas. F. Willey, his brother. He knew at that time more than four years before the commencement of this suit that the seven hundred dollars that was used by E. T. Willey was drawn from that special account. He at that time was disputing the claim of E. T. Willey, through the sheriff, to the said automobile because he believed it belonged to Chas. F. Willey and to substantiate this belief this bank record was produced at the trial.

We submit that under the disclosures that were made at that proceeding that his suspicions should have been aroused that other monies of Chas. F. Willey had also been transferred to E. T. Willey and that he was thereupon put under the obligation to further investigate and that further investigation diligently pursued would have disclosed the fact that the $1500.00 account stood also for a time in E. T. Willey's name and that it also had been transferred from the funds of Chas. F. Willey.

The plaintiff in error in his brief practically admits that our contention with reference to the statute of limitations is correct unless the action is governed by section 11d of the Bankruptcy Act.

We submit that this action is not governed by such section. Section 70e of the Bankruptcy Act which gives the trustee the right to bring this action, provides as follows:

> "A trustee may void any transfer by the bankrupt of his property *which any creditor of such bankrupt might have voided.*"

Now obviously under the very terms of the statute by which the trustee in this case is given the right to sue, he is given only the rights that were possessed by the creditor. In other words, he is subrogated to the rights of the creditor, and is governed and bound by the rules of law under which the creditor could act in setting aside such conveyance. In other words, this action is not strictly an action under the bankruptcy act. The bankruptcy act simply permits the trustee to assert the rights possessed by

the creditor. It does not give him any new rights whatsoever, and if the creditor represented by the trustee in this action was barred by the statute of limitations in the prosecution of this action, then the trustee is also barred.

The cases of *In re Mullen*, 101 Fed 413, and *Holbrook v. First International Trust Company,* Massachusetts, 107 N. E. 665, established the rule that section 70e subrogates the trustee only to the rights of the creditor.

In the case of *Holbrook v. International Trust Company,* an action was brought by the trustee in bankruptcy under section 70e of the United States Bankruptcy Act to recover payments made to the defendants, amounting to $1677.70. The defendants contended, first, that the trustee in bankruptcy could not avoid a transfer of property unless the debtor was insolvent within the definition of insolvent given by the Bankruptcy Act. Second, that the evidence was insufficient to show that the bankrupt was insolvent at the time of the transfer within the definition of the word under the Massachusetts insolvency act.

The court said in answer to these contentions:

> "The first two questions are founded on a misconception of the nature of section 70e of the Bankrupt Act. This section of the Bankrupt Act does not create in the Trustee in bankruptcy a new right to avoid transfers to property made by the bankrupt. All that it does is to give authority to the trustee to avoid any transfers of property made by the bankrupt

which any creditor might have avoided * * *. All that section 70e of the Bankrupt Act does is to give authority to the Trustee in Bankruptcy to enforce the rights of creditors to avoid fraudulent transfers of property made by the bankrupt if such fraudulent transfers have been made. That is to say, whether a particular transfer was or was not fraudulent as to creditors under section 70e *does not depend upon the United States Bankruptcy Act but upon the laws of the state which govern the tranfser of the property in question.* (Italics ours.) See in this connection, In re Mullen, 101 Fed. 413, Collier on Bankruptcy, Tenth Ed. 1042 G and cases cited there and in the foot-note, page 320. It follows that the definition of insolvency prescribed by the Bankruptcy Act, and the definition of insolvency adopted by this and other courts when that word is found in the Massachusetts Insolvency and other Bankrupt Acts have nothing to do with the question.

Under such circumstances it is not necessary in order to avoid a transfer as a transfer made to hinder and delay creditors that the transferor at the time of the transfer was insolvent. If the circumstances are such that the jury can find that the transfer was made with intent to hinder and delay creditors it was voidable."

In other words, the above case holds in a well reasoned decision that the definition of insolvency made in the Bankruptcy Act of the United States did not govern cases brought under section 70e, but that such cases must rest and fall upon the interpretation given to law by the state courts governing such actions.

The same rule is laid down in *In re Mullen,* which holds that section 70e of the Bankrupt Act gives to

the trustee in bankruptcy with respect to the setting aside of fraudulent conveyances only the same rights which are conferred upon the bankrupt's creditors, or any of them, by the common law or the statutory law of the particular state.

Collier on Bankruptcy, Tenth Edition, pages 1042 f and g, lays down the rule as follows:

> "In many cases the trustee will be able to sue under section 67e or section 70e. If under the latter, he must bring himself within the elements of pleading and proofs recognized by the statutes and decisions of his State. The important difference is that if the suit is based on the State law, the *State's statute of limitations applies.*"

In the case of *Manning v. Evans*, 156 Fed. 106, the court said:

> "Its effect (referring to 70e) is to subrogate the trustee to the rights of creditors. Its distinguishing feature is that it authorizes a trustee in bankruptcy to invoke the relief furnished by State laws to creditors for annuling transfers of property by their debtors."

In the case at bar there is only one creditor. The issue is not complicated by the fact that there are numerous creditors and numerous rights to be adjudged and determined. Here the only person whom the trustee represents is the creditor McGinn, and we submit that under the inexorable logic of the above decisions that the trustee is given only the rights that McGinn would have had had the suit been prosecuted in his name, and that there is no question if the suit had been prosecuted in McGinn's

name that the action would have been barred by the statute of limitations pleaded in our answer. The distinction that counsel for the plaintiff in this case failed to make is that this action is not strictly a bankruptcy action, and therefore is not governed by the provisions of the Bankruptcy Act, but is absolutely and wholly governed by the decisions of the state court and the common law that would have governed an action by the creditor to set aside similar conveyances.

In the case at bar it is governed by the sections of the Civil Code of California, viz, sections 3439 et seq., and by the decisions of the courts of the State of California and the United States courts, which are cited herein.

The only case based upon section 70e of the Bankruptcy Act cited by counsel to the contrary is the case of *Sheldon v. Parker,* 66 Neb. 610; 92 N. W. 923.

In this action the excerpt quoted by counsel in his brief is pure and absolute dicta and not necessary to the decision of the court. This dicta is contrary to the principles laid down in the cases which we have cited upon this phase of the action. In the case of *Sheldon v. Parker* (supra) the court lays down the following rule, which is the real point of the decision:

> "As these conveyances were recorded less than four years prior to the commencement of this action, and as there is no evidence in the

record before us to show that any discovery of the fraudulent character of such conveyances was made prior to the filing of the deeds for record, the presumption must obtain that that is the earliest date at which the creditors had notice of any fraud connected with the transaction *so that these actions would not be barred even under the laws of the State."* (p. 932.)

Under that decision, therefore, the action was not barred by the state statute, and everything said by the court with reference to the bankruptcy statute of limitations is, as I have said before, pure dicta.

The case of *Arnold Grocery Company v. Shackleford,* 140 Ga. 585; 79 S. E. 470, cited by counsel as sustaining their view, we submit clearly points out the distinction we are making, namely, that in an action strictly governed by the Bankruptcy Act, section II d controls, but that in an action brought under 70e it does not. In the Shackleford case the only question was whether the state statutes of four years' limitations applied. The court held they did not. In this connection the court said:

"The Arnold Grocery Company bought the goods in payment of a pre-existing debt, and consequently there was no contract, either express or implied to pay for them. It was not suggested that the purchase was made to defraud creditors or for other reasons that it was void at common law or under the statutes of this state. The action was therefore, in no sense, upon an open account or for breach of contract, either express or implied, and would not be barred by the state law as embodied in the above sections of the code. Except for the Bank-

ruptcy Act the trustee could have no action on account of the purchase of these goods by the Arnold Grocery Company. That Act contained provisions under which the trustee was authorized to sue the Arnold Grocery Company for the value of the goods merely by reason of the fact that the transfer was made within less than four months from the filing of the petition in bankruptcy, notwithstanding it was made in pursuance of a sale in payment of a pre-existing debt which was in other respects valid. * * * Section 60b of the Bankrupt Act was not designed in any event to give the bankrupt a cause of action against the transferee, and therefore a case under that statute would stand on a different footing from a suit or some right of the bankrupt which might by operation of law under section 70a of the Bankrupt Act have passed from the bankrupt to the trustee. Section II d was manifestly intended to apply among others to a case falling under section 60b of the act to the exclusion of any other statute of limitation."

If this action were brought under section 67e or under section 60b of the Bankruptcy Act it would be governed by section II d of said act, because in such cases the cause of action is founded upon the Bankruptcy Act, but under section 70e the cause of action is not founded upon the Bankruptcy Act but upon the rights that the creditor had under the state statutes and law. The trustee is only subrogated to those rights and is not given any new or enlarged rights. The cause of action being governed by the state law is certainly governed by the state statute of limitations as was said in the excerpt from Collier cited supra.

The judgment of the lower court should, therefore, be sustained.

Dated, San Francisco,
February 26, 1921.

Respectfully submitted,

William E. Billings,
Attorney for Defendant in Error.